SUPREME COURT, U. S.

FILED
APR 17 1974
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1558

ROBERT S. WALKER,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI

TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

GERALD M. BIRNBERG
MICHAEL ANTHONY MANESS
5959 West Loop South
Suite 606
Bellaire, Texas 77401
Attorneys for Petitioner

FIDELITY PRINTING COMPANY, HOUSTON

INDEX

	Page
Prayer	1
Opinion Below	1
Jurisdiction	1
Questions presented	2
Constitutional provisions and statutes involved	2
Statement of the case	4
Appendix I — Opinion and judgment of the U. S. Court of Appeals for the Fifth Circuit	A-1
Appendix II — Amended Verdict	A-16

CASES CITED

Bronston v. United States, 1973, ... U.S. ..... S.Ct. ....., ... L. Ed. 2d	8, 9
Gregory v. United States, 5 Cir., 1958, 253 F.2d 104, 109	9
Gravieres v. United, 1911, 220 U.S. 338, 342, 31 Sup. Ct. 421, 55 Law Ed. 489	13, 14
United States v. Foy, 5 Cir., 1971 441 F.2d 398	14

Books

Black's Law Dictionary	11
Webster's Seventh New Collegiate Dictionary	11

Statutes Cited

15 U.S.C. § 77q(a)	2, 3, 4, 12, 13, 15
18 U.S.C. § 1341	2, 3, 4, 13, 14, 15
18 U.S.C. § 371	2, 4
18 U.S.C. § 2113(a) and (b)	14
28 U.S.C. § 1254(1)	2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. .....

ROBERT S. WALKER,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI

TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

ROBERT S. WALKER, your petitioner, prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above entitled case December 18, 1973. A petition for rehearing was denied March 18, 1974.

OPINION BELOW

The opinion of the Court of Appeals has not been reported. A copy is appended as Appendix I.

JURISDICTION

The judgment of the Court of Appeals was entered December 18, 1973. Petition for rehearing was denied March 18, 1974.

Jurisdiction to issue the writ is invoked, pursuant to the provisions of Title 28, Section 1254(1), United States Code.

Petitioner was convicted in the United States District Court for the Northern District of Georgia on twelve counts of a multicount indictment charging him with violations of the provisions of Title 18, Section 1341, United States Code, Title 18, Section 371. United States Code, and Title 15, Section 77q(a), United States Code.

QUESTIONS PRESENTED

1. Whether it constitutes a criminal offense punishable under Federal Securities and Mail Fraud Statutes to offer and sell securities in an insolvent corporation where the prospectus used in soliciting such sales clearly reveals that the company is insolvent

2. Whether the term "fraud" as used in Federal Securities and Mail Fraud Criminal Statutes contemplates local standards of "moral uprightness, fundamental honesty, fairplay and right dealings" as a test for determining whether or not a particular course of conduct constitutes fraud?

3. Whether convictions for violating both 18 United States Code Section 1341 (mail fraud) and also 15 United States Code, Section 77q(a) (securities fraud) on the basis of the defendant having mailed one single security to one individual on one particular day violates constitutional guarantees against double jeopardy?

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The Fifth Amendment of the Constitution of the United States Provides:

> "No person shall . . . be deprived of life, liberty or property, without due process of law; . . ."

TITLE 15, SECTION 77q(a), UNITED STATES CODE provides:

> "It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mail, directly or indirectly —
>
> (1) To employ any device, scheme, or artifice to defraud, or
>
> (2) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

TITLE 18, SECTION 1341, UNITED STATES CODE, provides:

> "Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Post Office Department, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at a place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not

more than $1,000, or imprisoned not more than five years, or both."

TITLE 18, SECTION 371, UNITED STATES CODE Provides:

"If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both.

If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor."

STATEMENT OF THE CASE

Petitioner, along with Co-Defendants ROBERT B. BRUCE and ROBERT A. BLACKWOOD, was charged in a multi-count indictment in the United States District Court for the Northern District of Georgia with violations of the Federal Securities Act (15 U.S.C.A. § 77q(a)) and the Mail Fraud Statute (18 U.S.C.A. § 1341) and conspiracy to violate such statutes (18 U.S.C.A. § 371). The factual background giving rise to the indictment is complex, extended and of little import here. Essentially, however, the case grew out of the failure of the American Capital Corporation of which Defendant Walker was president, Defendant Blackwood was secretary and Defendant Bruce was the independent auditor. American commenced operations during mid-December, 1966, and ceased doing business in late April, 1969. Of the $215,960.84 received from inves-

tors, none was available for repayment to investors when the company ceased operations.

In essence, the government charged that the demise of American Capital Corporation was preordained and that the sale of its securities to investors was part of a plot to bilk unsuspecting victims by beguiling them with false and misleading prospectuses thereby deceiving them into investing money in the Corporation so that the Defendants could thereafter enrich themselves by misappropriating these funds. In furtherance of this theory, the government concentrated its attack on nine particular statements contained in the prospectuses of American Capital Capital Corporation which it contended to be misleading, though admittedly not false.[1]

Significantly (and herein lies the thrust of the Petitioner's Application for Writ of Certiorari) both the District Court who tried the case without a jury and the Court of Appeals apparently rejected the government's theory that these nine statements were criminally misleading. Nonetheless, the District Court convicted the Defendant and the Court of Appeals affirmed the conviction on the novel theory that the act of selling securities in an insolvent corporation constitutes a criminal offense under the Federal Securities Act, despite the fact that the prospectus clearly and unequivocally showed that the Corporation was insolvent.[2]

---

[1] The nine alleged statements and a summary of the argument relating to them is set forth in the appellant's brief to the Fifth Circuit, included in the record in this cause. Since those nine statements are not involved in this Application for Certiorari, they are not set forth herein. However, the brief of the Appellant below is hereby incorporated herein by reference for all purposes.

[2] In the words of the Court of Appeals, "On the face of the financial statements contained in the new prospectus, it is obvious that the Company was solvent." Slip op at p. 5.

Defendant Walker was convicted on twelve of fifteen counts included in the indictment and was sentenced to serve three years in federal custody on each count, with the sentences to run concurrently. From that conviction an appeal was duly perfected to the Fifth Circuit Court of Appeals, from whose decision affirming the conviction this Application for Writ of Certiorari has been filed.

REASONS FOR GRANTING THE WRIT

This case presents three distinct questions of far reaching significance involving the scope of federal criminal statutes regulating securities transactions. With regard to each of these three questions, the Fifth Circuit has announced new and far reaching standards which could have a most profound effect nationwide and therefore merit this Court's scrutiny and consideration before inter-circuit conflict develops greatly complicating an already complex area of the law.

I.

The Fifth Circuit erred in affirming the District Court's pronouncement that the act of offering securities in an insolvent Company is per se violative of federal securities and mail fraud laws, even if the prospectus clearly says on its face that the Company is insolvent at the time.

The reason why the Defendant was convicted is plainly set forth in the District Court's Opinion: "By the time of the issuance of that prospectus on April 5, 1968, all of the Defendants knew and could not have failed to know that the business they were conducting was a fraud * * * The very balance sheet and statements of condition *contained in the second prospectus*, which were prepared by Defendant Bruce from information supplied by Defendants Blackwood

and Walker, showed on their face that for the year 1967 the Company had incurred a net loss of $131,825.00 and that for the period from January 1, to February 13, 1968, it had incurred a net loss of $693,196.50. The balance sheet as of February 16, *likewise appearing in the second prospectus,* showed a deficit net worth at that time of $89,005.33 and an earned deficit, after quasi-reorganization, of $112,452.63." Similarly, the Court of Appeals confirmed the conviction because, "On the face of the financial statements *contained in the new prospectus,* it was obvious that the Company was insolvent." (Emphasis supplied)

The prospectus in controversy clearly disclosed that the Company had a deficit net worth of $89,000.00 and it had incurred a net operating loss during the previous year in excess of $800,000.00 (including a non-recurring loss on the foreclosure of certain real estate in the amount of $682,000.00). Liabilities were listed at $244,000.00 against assets of only $155,000.00. The prospectus also revealed, no fewer than three times, that a subsidiary of the Company had just come out of bankruptcy proceedings. No one contests — indeed it is the very basis of the District Court's verdict — that the financial statements of the Company contained in the prospectus clearly revealed, "on their face", that the Corporation was insolvent at the time.

Thus, the most significant question presented in this case can be simply stated: Do the Federal Securities Act and the Federal Mail Fraud Statutes prohibit the offer and sale of securities in an insolvent Company where the prospectus used clearly shows the Company to be insolvent?

The significance of the case is self evident. Despite the fact that the Federal Securities Laws were originally promulgated simply to insure full disclosure in securities transactions, the scope of the laws has been greatly expanded

to include, as well, protection of potential investors against loss in financially risky ventures which ultimately fail. If the activity of the Defendants in this case constitutes a violation of Federal Securities Laws and the Mail Fraud Statute, then every person offering securities in a financially troubled business which ultimately fails faces the prospect of federal prosecution. What the Defendant was guilty of was selling securities in a failing business, whose prospectus, by the Court's admission (indeed, reliance) clearly indicated the dire financial condition of the business.

The Court of Appeal's holding marks a major development in securities fraud cases. Heretofore the test for determining fraud has been whether or not the prospectuses were false or misleading. The apparent purpose of the criminal statutes was to assure that potential investors were not misinformed about the condition of the business. With the new interpretation given to the statutes by the Fifth Circuit, however, assuring complete disclosure is no longer the function of the federal laws. Rather, the laws as now interpreted make it unlawful to offer securities in a financially troubled business, even if the dire financial circumstances are fully revealed and disclosed. Defendants strenuously argue that such activity is not prohibited by the Federal Mail and Securities Statutes and that such laws were never intended to effect that result. The conduct for which the Defendants were convicted, offering securities in an insolvent Company on the basis of a prospectus which clearly revealed that insolvency, simply is not within the purview of the present law. It is not — or more correctly, was not previously — against the law.

In this regard, the Fifth Circuit failed to perceive the significance of this Court's recent decision in the case of *Bronston* v *United States*, 1973, ... U.S. ..... Supreme Court ....., ... L. Ed. 2d ..... In that case this Court was

asked to determine whether the federal perjury statute should be broadly construed to encompass statements which were argueably misleading by negative implication or strictly construed to prohibit only literal untruth. This Court concluded that "the vague rubric of 'intent to mislead' or 'perjury by implication'" was improper as a standard for federal perjury convictions, expanded the intent of Congress in passing the Federal Perjury Statute, and exceeded the literal requirements of the Federal Statute. Accordingly, Bronston's conviction for perjury was reversed.

The Court of Appeals has made the same error in this case that the Second Circuit made in the *Bronston* case. Despite the literal correctness of the financial statements, the implication of possible success inherent in the act of offering the securities for sale constituted misleading conduct which was therefore deemed fraudulent. But if the prospectus is literally true and shows unequivocally that the company is in dire financial straits, does the act of offering such securities for sale nonetheless constitute a criminal offense? This is the question of obvious national significance which the Petitioner suggests should be answered in the negative and requests this Court to consider by Writ of Certiorari.

II.

In its decision in this case, the Fifth Circuit announced a new and far reaching definition of "fraud" which greatly expands the scope of the federal jurisdiction in every day business transactions. "Essentially, a scheme to defraud is measured by a nontechnical standard. 'It is a reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the general and business life of members of society', *Gregory* v. *United States*, 5 Cir., 1958,

253 F.2d 104, 109." Slip Op. at P. 12. The Court explains that a scheme to defraud need not even be fraudulent or misrepresent any material fact to be a violation of federal law, if persons of ordinary prudence and comprehension could be misled as to the *possible* future value of an investment in a particular business endeavor.

The implications of such an expansion of the definition of federal fraud offenses are self-evident. In the first place, fraud cases now become like obscenity cases. The question which determines criminality is not whether there was an intent to obtain money or property through false pretenses (or failure to disclose material facts), but rather, whether the course of business dealings of the Defendant adequately reflected the community's ideals of "moral uprightness" and "right dealing", whatever those terms mean. If a businessman does not "play fair", and, incidentally he uses the United States mails, he is guilty of a federal mail fraud, under the new definition of that statute supplied by the panel opinion. Significantly, though the opinion details the Government's allegations in some detail, it never states that any one act of the Defendants was false or misleading. Instead, the Court simply holds that the record, taken as a whole, contained substantial evidence that the Defendants' actions did not reflect "moral uprightness, fundamental honesty, fair play and right dealing."

The place where the Fifth Circuit apparently erred in concluding that the federal mail and securities fraud statutes encompassed "immoral" business activity even in the absence of misrepresentation of or omission of material facts or a scheme fraudulent upon its face, is in believing that the word "deceive" in the statutes encompasses activity broader than misrepresentation. Clearly this is not so. The Court attempts to make a distinction which simply is inefficacious. "The scheme need not be fraudulent upon its

face or misrepresent any material fact. All that is necessary is that it be a scheme reasonably calculated to deceive persons of ordinary prudence and comprehension." Slip Op. at P. 12. *Black's Law Dictionary*, however, defines the word "deceit" as "a *fraudulent* and cheating *misrepresentation*, artifice, or device used by one or more persons to deceive and trick another, *who is ignorant of the true facts*, to the prejudice and damage of the party imposed upon.*** A *fraudulent misrepresentation* or contrivance, by which one man deceives another, *who has no means of detecting the fraud*, to the injury and damage of the latter.*** To constitute 'deceit', the statement must be untrue." Lay dictionaries concur with this definition. For example, *Webster's Seventh New Collegiate Dictionary* defines the word "deceit" as "to cause to believe an untruth" and the lead synonym listed is "mislead".

Marginal as was the evidence of misrepresentation, even more non-existent was the evidence of deceit, at least as that term is defined by *Black's*. Deceit requires that the victim "is ignorant of the true facts" and "has no means of detecting the fraud". By the Court's admissions, the insolvency of the Company was unequivocally apparent on the face of the prospectus given to each potential investor. And, as the Court's opinion admits, it was obvious on the face of the financial statements contained in the prospectus that the Company was insolvent. Where then lies the deceit? The means of detecting the alleged fraud was given to every investor and, by the Court's admission, not even the Government contended that the statements contained therein were untrue.

Surely the federal fraud statutes, touching as they do the activities of innumerable businessmen everyday, require definition with greater clarity than that presented in the Court's opinion. At the very least, the semantic difficulties

posed by the Court's confusing attempt to distinguish between misrepresentation and deceit demands further explication by way of certiorari.

III.

Counts II and XII of the inditement, both of which the Defendant was convicted of and sentenced for, are virtually identical. Count II reads as follows:

> "1. The Grand Jury realleges all of the allegations contained in paragraphs 1 to 18, inclusive, to Count One to this indictment.
>
> 2. On or about November 3, 1967, the defendants and West did willfully and unlawfully, in the offer and sale of a security, namely, the common stock of American Capital Corporation, by use of the mails, employ the aforesaid scheme and artifice to defraud, obtain money and property by means of untrue statements of material facts and omissions to state material facts in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and engage in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of said securities, including Thomas D. Wyatt, said use of the mails being as follows: On or about November 5, 1967, in the Northern District of Georgia, the defendants and West willfully caused a letter dated November 3, 1967, enclosing a stock certificate of American Capital Corporation, to be delivered by the Post Office Department to Thomas D. Wyatt, 512 Fairground Street, Apt. B, Marietta, Georgia, 30060; in violation of Section 77q(a), Title 15, U.S. Code."

Count XII charged as follows:

> "1. The Grand Jury realleges all of the allegations contained in paragraphs 1 to 18, inclusive, of Count One of this indictment as constituting and describing

a scheme and artifice which the defendants and West devised and intended to devise to defraud and to obtain money and property by means of false and fraudulent pretenses, representations and promises.

2. On or about November 3, 1967, in the Northern District of Georgia, the defendants for the purpose of executing the aforesaid scheme and artifice to defraud and attempting to do so, unlawfully, willfully and knowingly cause to be delivered by U. S. Mail according to the direction thereon an envelope and contents addressed to Mr. Thomas D. Wyatt, 512 Fairground Street, Apartment B, Marietta, Georgia, 30060, said contents consisting of a letter on American Capital Corporation; in violation of Section 1341, Title 18 U.S. Code."

As can be readily seen, both Counts charged (1) all of the allegations contained in Count I of the indictment; (2) a scheme and artifice to defraud; (3) the mailing of a letter and stock certificates to Mr. Thomas D. Wyatt, 512 Fairground Street, Apt. B, Marietta, Georgia, 30060, on November 3, 1967.

Petitioner's objection that conviction on both Counts constitutes double jeopardy was rejected by both the District Court and the Court of Appeals. The Fifth Circuit ruled that since there was an element in the § 77q(a) provision which was not present in the § 1341 conviction (the offer or sale of a security), there is no "complete mutuality" of offenses and therefore the double jeopardy clause is not offended.

The proper test for determining whether or not a double jeopardy problem is presented is not whether there is "complete mutuality" but whether *each provision requires proof of a fact which the others do not.*" Gravieres v. United States, 1911, 220 U.S. 338, 342, 31 S.Ct. 421, 55 L. Ed.

489. Obviously, the mail fraud provision (§ 1341) does not require proof of any fact which is not required in the securities fraud provision. Accordingly, conviction on both counts could not stand under the "each provision" test of *Gravieres*. The Fifth Circuit, however, has announced a new double jeopardy test which changes the word "each" to the word "either" in the prior standard. Thus, under the new test announced by the panel below, the test to determine whether there are two offenses or only one is whether *either* provision requires proof of a fact which the other does not. Since the security fraud provision required proof of an offer or sale of securities, but the mail fraud provision did not, the panel held that there was no violation of double jeopardy.

The clear departure from prior law marked by the new test is most obvious in the context of the federal bank robbery cases. A person cannot be convicted on both 18 U.S.C.A. § 2113(a) and (b) for the same bank robbery. *United States* v. *Foy,* 5 Cir., 1971, 441 F.2d 398. The two sections are identical, except that 2113(a) requires proof of an additional element — force and violence or intimidation. If the Fifth Circuit's new double jeopardy standard is retained, however, conviction under both (a) and (b) would be acceptable since (a) requires proof of an element which (b) does not require. In fact, the whole concept of "lesser included offense" is obliterated by the panel's new double jeopardy standard, and for this reason alone, the opinion is certworthy.

Explained symbolically for ease of understanding, suppose that Offense I required proof of elements (a), (b) and (c), and Offense II required proof of element (a), (b) and (d). Conviction on both counts would not constitute double jeopardy in that case because *each* provision

requires proof of an element which the other provision does not. Offense I requires proof of element (c) (which Offense II does not require) and Offense II requires proof of element (d) (which Offense I does not require). If, on the other hand, Offense I required proof of elements (a) and (b) only, conviction on both counts would constitute double jeopardy, because, while Offense II does require proof of an element not required to prove Offense I (namely, element (d)), Offense I does not require proof of any element not required to prove Offense II. This, of course, is precisely the situation with the case at bar and the statutes involved herein. As the Court points out, only the § 77q(a) violation requires proof of an element not present in the § 1341 charge. There is nothing in the § 1341 offense which is not also present in § 77q(a) offense.

Perhaps the Court's holding resulted simply from a misapplication of existing law and was not intended to abandon the prior test as it in fact did. Nevertheless, the holding is far reaching. Moreover, as the decision now stands, a new standard has been announced and Supreme Court consideration of such a significant new theory of double jeopardy is clearly indicated.

CONCLUSION

The Fifth Circuit has announced several far reaching new standards which deserve the consideration of this Honorable Court. The issues are of obvious significance nationwide and ought to be considered by this Court. Therefore, the Application for a Writ of Certiorari ought to be granted.

Respectfully submitted,

.....

GERALD M. BIRNBERG
MICHAEL ANTHONY MANESS
5959 West Loop South
Suite 606
Bellaire, Texas 77401
(713) 664-7782
Attorneys for Defendant

APPENDIX I

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 73-1398

UNITED STATES OF AMERICA,
Plaintiff-Appellee,

v.

ROBERT B. BRUCE, ROBERT A. BLACKWOOD
and ROBERT S. WALKER,
Defendants-Appellants.

Appeals from the United States District Court for the Northern District of Georgia

(December 18, 1973)

Before BELL, COLEMAN and RONEY,
Circuit Judges.

COLEMAN, Circuit Judge: Judge Edenfield, of the United States District Court for the Northern District of Georgia, sitting without a jury, convicted these appellants on various counts of securities fraud, U.S.C., § 77q(a), mail fraud, 18 U.S.C., § 1341, sale of unregistered securities in interstate commerce, 15 U.S.C., § 77e(a), and conspiracy to violate the aforesaid statutes, 18 U.S.C., § 371, with individual variations, all counts basically charged the defendants with the unlawful use of the mails in the execution of a fraudulent scheme to sell certain securities.

The appellant, Walker, was convicted on twelve counts and sentenced to serve concurrent terms of three years.

Bruce was convicted on two counts and sentenced to concurrent terms of two years, of which six months must be spent in a penal institution.

Blackwood, an attorney, was convicted on three counts and sentenced to consecutive terms of five years, suspended, with three years probation, as Blackwood was by that time already in prison on other charges.

Except as to Blackwood's conviction on Count 14, which will be reversed, the judgment of the District Court is affirmed.

On appellate review this Court must view the evidence and the reasonable inferences to be drawn therefrom in that light most favorable to the verdict and must determine as a matter of law whether there is substantial evidence, direct or circumstantial, to support the verdict, *Glasser* v. *United States*, 315 U.S. 60, 62 S.Ct. 457, 86 L.Ed. 680 (1942); *United States* v. *Jacobs*, 5 Cir., 1971, 451 F.2d 530. In circumstantial evidence cases, the trier of fact must "reasonably find that the evidence excludes every reasonable hypothesis, except that of guilt", *United States* v. *Sidan-Azzam*, 5 Cir., 1972, 457 F.2d 1309. If a conviction is attacked on the ground that the evidence was insufficient to support it there will be an affirmance if it is evident that the findings are not clearly erroneous, *United States* v. *Davis*, 5 Cir., 1971, 443 F.2d 560, cert. denied 404 U.S. 945 (1971); *United States* v. *Graves*, 5 Cir., 1970, 428 F.2d 196, cert. denied 400 U.S. 960 (1970).

In one way or another, each appellant challenges the sufficiency of the evidence.

The Fraud

The alleged scheme in this case is predicated upon the incorporation and operation of American Capitol Corporation [hereafter referred to as American or as the Company]. The defendants were either officers of the Company or professionally retained by it. The list included those responsible for the drawing of the two prospectuses which the prosecution contends were false and misleading. Defendant Walker was the primary incorporator and also the President of American.

On December 13, 1966, American was incorporated in Atlanta, Georgia. To avoid coming within the provisions of the Investment Company Act of 1940, 15 U.S.C., §80a(1) et seq., and to aid in the composition of the required prospectus, Walker retained Robert A. Blackwood, an Atlanta attorney. Georgia laws and regulations required the prospectus to contain an elaboration upon the financial condition of the Company by way of certain certified statements. To meet this condition, Walker first approached an accountant with a national accounting firm. After ascertaining what Walker wanted in the financial statement, this accountant turned Walker down because the policy of his firm toward the use of appraisal value in financial statements for newly formed companies would not allow him to do what Walker wanted. [The particular controversy surrounding the use of certain appraisal values will be discussed later.] Walker then contacted Defendant Robert B. Bruce, at the time a C.P.A. in Florida, who agreed to do the necessary accounting work. The first prospectus was offered to the public on January 31, 1967.

As a means of obtaining capital funding, the Company offered two types of securities to the general public: common stock and interest-bearing investment certificates.

Initially, the incorporators (and others close to them) received 47% of the stock. On its face, this was not illegal. The problem arises from the fact that while the stock was selling to the general public for $2 a share, the insiders received stock for "incorporation services" amounting to 285,000 shares in return for evaluated consideration of only $20,000.

In the very first year, American went from a surplus to a deficit net worth. In the early part of 1968, the Georgia Securities Commission forbade American to sell any more securities until a new prospectus had been filed. On or about April 5, 1968, a new prospectus, dated June 1, 1968, was submitted to the Commission and offered to the public. On the face of the financial statements contained in the new prospectus, it was obvious that the Company was insolvent. Finally, in May of 1969, the Company went out of business.

The Government concedes that neither the 1967 nor the 1968 prospectus was false *per se*, but it does contend that they were deliberately and fraudulently misleading.

In the Bench trial below, the hotly contested issues seemed to center around the commissions paid to the securities salesmen, the use of the proceeds received from the sale of the securities, the way the cash assets were presented, certain notes receivable, the value of the land in Florida, listing of unaudited values of a subsidiary alongside audited values, certain footnotes in the prospectuses, and the failure to list certain assets and debts.

The first prospectus represented that the expense of the sale and distribution of the securities would be no higher than 4% for the certificates and 15% for the stock. In actuality, the salesmen received 20% on the certificates and 33⅓% on the stock.

Next came the use of the proceeds of the securities sales. The prospectus showed that the Company would engage in the investment banking business by purchasing commercial paper, making secured loans, and purchasing securities of other companies. In actuality no funds were ever advanced toward the stated purposes — although American did assume certain obligations in the acquisition of the assets in Babee-Tenda Products Corporation, a wholly owned subsidiary of American. Instead, many loans were made to insiders, totalling $54,499, of which only $33,415 was ever repaid.

The third alleged misrepresentation concerns the cash assets stated in both prospectuses. In the first, the financial statement was drawn on the 13th day of December, 1966. Two days later, but before the prospectus was completed, a disbursement of $15,000 was made and recorded on the company's books as an exchange item. This item was later removed by an adjusting entry against capital.

In the second prospectus, the cash entry in the financial statement showed $42,809.25. The chief accountant with the Atlanta Regional Office of the Securities and Exchange Commission, the government's expert witness, testified that $40,000 of the sum was borrowed from a bank, placed in a savings account, and then pledged as collateral for the original loan. About a month later, the loan was repaid, and the savings account was closed. A footnote was included explaining this loan but when told such had to be included Walker asked that it not be the first one.

Another irregularity in the case was the failure of Bruce to include an outstanding check for $2,000 which was written prior to the date of the statement. This $2,000 was given as a down payment for an airplane which was not included in the assets of the Company, nor was the debt thus in-

curred included in the liabilities. Had the prospectus clearly reflected these items, the cash would have actually been $809.35, not $42,809.35.

The next questionable entry concerned a note for $20,000 given to American by Blackwood as payment for 40,000 shares of stock. The government contends that the entry and accompanying footnote were misleading. A footnote stated that Blackwood owed the Company $20,000 on a note receivable bearing 6% interest on or before December 8, 1967. It stated further that the only security for the note was 40,000 shares of American Capital Corporation. In actuality, the note contained a stipulation on the back that it could only be satisfied from the 40,000 shares and did not represent a general indebtedness on the part of Blackwood. The government contended that this was not a valid, enforceable note and should not have been included as such.

The biggest dispute arose over the use of a MAI appraisal for the value of the land American had title to in Florida. This property was purchased from Diversified Enterprises of Florida by incurring obligations amounting to $380,387.74 and issuing 35,000 shares of American stock. The government contended that the true value of the entire parcel did not amount to any more than the debt against it.

The value in the prospectus, based upon a MAI appraisal while the land was still in the hands of Diversified, was listed at $1,076,600. The government produced a witness who aided in the composition of the report and who stated that the report was an aggregate value based upon total sale of the individual lots, plus certain additions to the land which were to be made. He stated it did not represent the current value of the land as a whole, prior to subdivision and development.

A note in the first prospectus recorded the various debts of the Company but in exact terms it never stated how much the Company owed on the Florida property, nor did the prospectus reveal that the mortgage on the land was overdue when the Company purchased it. The Government contends that the use of the MAI appraisal overstated the stockholders' equity by $716,212.26.

The second prospectus reported that the Florida property had been foreclosed. The Government was particularly affronted by the inclusion of the loss of this property in the comparative statement of income and expenses for the year 1968, contending that it should have been included in 1967's statement as that was the year the foreclosure actually occurred. By placing the loss in 1968, the Government contends that the stockholders' equity was grossly misstated for the year 1967.

Another of the Government's objections related to the inclusion of unaudited figures with audited figures in a footnote explaining the acquisition of Babee-Tenda Products Corporation. This entry, it contends, could be misleading to the buying public, as to the actual value of the property.

The controversial footnote showed, in essence, that the assets of Babee-Tenda Safety Products Corporation were acquired from Babee-Tenda's creditors in bankruptcy by exchanging 26,388 shares of American stock and by the assumption of $75,000 in notes payable. It further stated that the unaudited sales of the newly acquired company was approximately $2,000,000 per year, and the unaudited net worth was reported to be $289,000. Accordingly, this acquisition represented an unrealized, unaudited appreciation in the book value of American in excess of $211,000.

Evidence was also introduced clearly implicating Walker and Blackwood in a scheme whereby they bribed certain Labor Union officials to invest union pension funds in American investment certificates in violation of federal law. The fact that the Union had invested in these certificates was later used as a selling point in some of the Company's promotional material.

In getting down to the nuts and bolts, the Government conceded that the financial statements were not patently false, but asserted that by the addition of footnotes the perpetrators of this alleged fraud intended to mislead and did mislead the buying public into believing that the Company, although inescapably insolvent, had a good chance of becomin[illegible] a one and a half million dollar company by paying $300,00[illegible] an option to get back the Florida property and by merging with Diversified, which by the time of the second prospectus was in the throes of bankruptcy proceedings.

As a final clincher, the Government introduced evidence of wasteful spending by Walker and Blackwood. For instance, Walker rented a Cadillac, for which the Company paid $1,512. Payments amounting to $2,486.50 were made on Walker's personal automobile loans. The Company also paid $5,822.96 on apartment rent and furniture for Walker, and he received loans totalling $6,315.96 of which only $2,529.35 was ever repaid. In total, Walker received $47,907.14 in benefits from American.

Blackwood also received the use of a rented Cadillac for which the Company paid $1,576. At the time he had the Cadillac Blackwood did not receive any legal fees. Blackwood also received loans of $1,705.60. In total, Blackwood received $10,421.60.

Bruce only received $1,800 in professional fees, plus some expenses.

In the aggregate, the three Defendants received $60,128.74, or 20% of the cash taken in during the life of the Company.

The Government contends that each of the Defendants helped produce the means of inducement — both prospectuses — in the fraudulent scheme. The proof, viewed in the light most favorable to the prosecution, showed that Walker, Blackwood, and Bruce were primarily responsible for the compilation of "facts" which went into each of the prospectuses and that Blackwood actually prepared the footnotes for the second one. As the accountant, Bruce was responsible for the compilation and formulation of the financial data contained in both. It is argued that since this was purely a professional service, involving matters of judgment, and was not *per se* false, Bruce should have been acquitted. Ordinarily, this should be so, but the record contains evidence clearly indicating that Bruce knew the full implication of what he was doing, yet hesitated not.

The appellate record is composed of twelve typewritten volumes.

In his written verdict, filed February 8, 1973, Judge Edenfield stated that he had "no hesitation in holding the defendant Walker guilty as charged" except for one count on which he found both Walker and Bruce not guilty.

He found Bruce and Blackwood not guilty on ten counts connected with the first prospectus.

As to the second prospectus, Judge Edenfield found that "all of the defendants *knew and could not have failed to know* (emphasis added) that the business they were con-

ducting was a fraud"; that while the Company had collected "over $200,000 from the sale of stock and investment certificates, it had not devoted a single dollar of the Company's assets to the purposes for which the corporation was purportedly created, but instead had squandered and spent vast sums of the Company's assets * * * all without having earned one dime for stockholders or investors".

Essentially, a scheme to defraud is measured by a non-technical standard. "It is a reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the general and business life of members of society", *Gregory* v. *United States*, 5 Cir., 1958, 253 F.2d 104, 109.

The scheme need not be fraudulent upon its face or misrepresent any material fact. All that is necessary is that it be a scheme reasonably calculated to *deceive* persons of ordinary prudence and comprehension. The intent of the crime is shown by the scheme itself — here, the active promotion of a company known to be inescapably insolvent by making impossible representations of possible wealth to potential investors, *Silverman* v. *United States*, 5 Cir., 1954, 213 F.2d 405, cert. denied 348 U.S. 828 (1954).

We must conclude that there was substantial evidence in this case from which the Judge could determine that the defendants were guilty. That being so, his verdicts stand impervious to appellate attack.

Former Jeopardy

Defendant Walker, being the only one in a position to do so, objects to his conviction on Counts II and XII of the indictment, arguing that conviction of both violated his privilege against former jeopardy. Basically, Counts II and XII arose from the same set of facts, but the counts alleged violations of different statutes.

Although Walker does not show how he was prejudiced or harassed, such would be irrelevant as each count alleges commission of a separate offense.

Generally speaking, "where the same act or transaction constitutes a violation of two or more distinct stautory provisions, the test to determine whether there are two offenses or only one is whether each provision requires proof of a fact which the others do not", *Gravieres* v. *United States,* 220 U.S. 338, 342, 31 S.Ct. 421, 55 L.Ed. 489 (1911).

Both statutes involved here have mutual elements of proof in all but one point. 15 U.S.C., §77q(a) requires that the following elements be proved beyond a reasonable doubt:

> "1. The offer or sale of a security;
>
> "2. By use of the mails or some means of transportation or communication in interstate commerce; and
>
> "3. That the defendant intentionally did any of the following:
>
> (a) employed a device, scheme, or artifice to defraud;
>
> (b) obtained money or property by means of material misrepresentations or material misleading missions;
>
> (c) engage in a transaction, practice or course of business which would or did operate as a fraud or deceit upon a purchaser of securities."

All that is required to prove a mail fraud charge is (1) the scheme to defraud; representations known by the defendants to be false or misleading; some person or persons must have been defrauded, and (2) causing something to be sent through the mails in execution of the fraudulent scheme, *Bass* v. *United States,* 5 Cir., 1969, 409 F.2d 179,

cert. denied 396 U.S. 863, rehearing denied 396 U.S. 950 (1969); *Silverman* v. *United States, supra.*

Although, as mentioned before, there are mutual elements of proof, there is one element in 77q(a) which is not present in § 1341— the offer or sale of a security. The result is that Walker's attack must fail for lack of complete mutality. See, also, *United States* v. *Williams,* 5 Cir., 1970, 424 F.2d 344; 447 F.2d 1285 (En Banc, 1971).

The Sale of Unregistered Securities in Interstate Commerce

The ultimate question to be answered here is whether Blackwood could be considered an "underwriter" at the time of the attempted transfer to Mrs. Ruth Gaygan of stock which he personally owned.

15. U.S.C., § 77d(1) exempts the application of § 77e(a) to all *"transactions* by any person other than an issuer, underwriter, or dealer". The Government, in its brief here, strongly contends that Blackwood comes within the definition of an underwriter as found in 15 U.S.C. § 77b(11). The pertinent portion of that section is as follows:

> "The term 'underwriter' means any person *who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security,* or participates or has a direct or indirect participation in any such undertaking, or participated or has a participation in the direct or indirect underwriting of any such undertaking . . ." [Emphasis added.]

The Government has overlooked two essential elements to a valid conviction. First, it argues that Blackwood does not come within the § 77d(1) exemption because he is an underwriter; i.e., one who provides an outlet for the stock of an "issuer", *United States* v. *Re,* 2 Cir., 1964,

336 F.2d 306. cert. denied 379 U.S. 1001 (1965). The fact is apparent that the government is in actuality arguing that Blackwood falls within a class — i.e., "underwriters" — while overlooking the point that § 77d(1) exempts transactions, not classes, *Pennaluna & Company* v. *S.E.C.*, 9 Cir., 1969, 410 F.2d 861, cert. denied 396 U.S. 1007 (1969).

Since it is the transaction which provides the indicia of the crime, the Government must prove that the transaction complained of is, in fact, a violation. As § 77d(11) stated, an underwriter is one who takes from an issuer with a view toward distribution to the general public. The Government has failed to produce any evidence that Blackwood did anything but acquire stock from American for his own personal account. The facts further show that the circumstances under which Blackwood attempted to transfer 2,000 shares of his stock to Mrs. Gaygan was a personal matter, spanning a four to five year period, and in no way involved a solicitation of the type covered by 15 U.S.C. § 77e(a).

The result is that we REVERSE Blackwood's conviction on Count 14.

Except as to Blackwood's conviction on Count 14, which is reversed, the judgment of the District Court is, in all other respects, AFFIRMED.

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1973

No. 73-1398

D. C. Docket No. 26904

UNITED STATES OF AMERICA,
Plaintiff-Appellee,

v.

ROBERT B. BRUCE, ROBERT A. BLACKWOOD
and ROBERT S. WALKER,
Defendants-Appellants.

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR
THE NORTHERN DISTRICT OF GEORGIA

Before BELL, COLEMAN and RONEY,
Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Georgia, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that except as to Blackwood's conviction on Count 14, which is reversed, the judgment of the District Court is, in all other respects, affirmed.

December 18, 1973

Issued as Mandate.

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 73-1398

UNITED STATES OF AMERICA,

Plaintiff-Appellee.

v.

ROBERT B. BRUCE, ROBERT A. BLACKWOOD
and ROBERT S. WALKER,

Defendants-Appellants.

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR
THE NORTHERN DISTRICT OF GEORGIA

ON PETITION FOR REHEARING

(March 18, 1974)

Before BELL, COLEMAN and RONEY,
Circuit Judges.

Per Curiam:

IT IS ORDERED that the petition for rehearing filed on behalf of Robert S. Walker in the above entitled and numbered cause be and the same is hereby Denied.

APPENDIX II

UNITED STATES DISTRICT COURT

Northern District of Georgia

Atlanta Division

United States of America vs. Robert A. Blackwood Robert B. Bruce Robert S. Walker	Criminal No. 26,904

Amended Verdict

(Filed February 8, 1973)

The original verdict dated November 21, 1972 and filed on November 22, 1972, is hereby designated null and void and of no legal effect and in lieu thereof this amended verdict is hereby entered and filed.

This case involves another of those combination mail and securities frauds which have plagued the intrastate securities market intermittently since World War II.

The issuer in this instance was the American Capital Corporation which was incorporated in Georgia in 1966. Its organizer and president was the defendant Walker. He caused the company to be formed, planned the first prospectus of January 31, 1967, and the company's sale material. Later he also spent most of the company's money. Before organizing the company he succeeded in obtaining paper title to a valuable but heavily encumbered piece of Florida land. This property, which was used to generate a very dubious net worth on the company's balance sheet, was also the company's only tangible asset and almost ex-

clusively constituted the "bait" on the strength of which the stock and investment certificates were sold. It was acquired, at a total cost of $380,387.74 and without cash, by having the company reassume or guarantee the indebtedness against the land, issue $70,000 in notes and by giving to the sellers president 35,000 shares of the company's organizational stock, most of which had been issued to the officers gratuitously and in consideration of their "services" in organizing the company. The encumbrances against the land were in default when the land was acquired.

Walker then found or produced a CPA, who had worked with him before, and who was later de-certified, who "window dressed" the company's balance sheet by putting in this land at an appraised value of $1,076,600, based on an earlier but updated MAI appraisal.

The aim and avowed purpose of the company was to lend money to new and smaller companies and to improve on the mutual fund concept by having the company promise to "guarantee" to the investors a 6% return, without any loading charge to the investors, plus a right to proportionately share in 25% of the company's anticipated profits. The 6% return was later raised to a promise of 7%, and this at a time when, by its own admission, the company was already insolvent.

The defendant Blackwood, an attorney, was employed to register the venture with the Securities Commissioner of Georgia and to steer it around and past the Investment Company Act of 1940, 15 U.S.C. § § 80a-1, *et seq.*

During its two-year history the company sold in excess of $200,000 in stock and investment certificates and spent the proceeds without, so far as the court can ascertain, ever making a single cash investment of the kind contemplated by the charter and the prospectus.

Counts Seven and Eleven of the indictment were dismissed by the Government for want of evidence.

Omitting the conspiracy count which will be dealt with later, the court has no hesitation in holding the defendant Walker guilty as charged on each of the remaining substantive counts of the indictment, except Count Fourteen, which involves a collateral but separate charge relating to defendant Blackwood alone. Specifically, the court finds defendant Walker guilty on each of Counts One, Two, Three, Four, Five, Six, Eight, Nine, Ten, Twelve and Thirteen.

As to the other two defendants, Bruce and Blackwood, the court entertains a doubt — shaky, but nevertheless reasonable — as to whether they initially entered upon this scheme to defraud in bad faith; and since good faith is an absolute defense to a mail fraud charge [*United States* v. *Diamond*, 430 F.2d 688 (5th Cir. 1970); *Beck* v. *United States*, 305 F.2d 595, *cert. denied* 371 U.S. 890 (1962)], the court is constrained to find those two defendants not guilty with respect to those counts of the indictment dealing with the distribution and mailing of the original prospectus or with respect to subsequent sales made pursuant to it during the year 1967 and prior to the issuance and mailing of the second prospectus in April 1968. Specifically, the court finds the defendants Bruce and Blackwood not guilty on Counts One, Two, Three, Four, Five, Six, Eight, Ten, Twelve and Thirteen of the indictment.

The evidence as to the issuance of the second prospectus and the activities of all the defendants pursuant to it, present an entirely different picture.

By the time of the issuance of that prospectus on April 5, 1968 (Government Exhibit No. 12) all of the defendants knew and could not have failed to know that the business they were conducting was a fraud. By that time they knew that the encumbrances against the Florida land had been

foreclosed, a fact which they tried to explain away in footnote 8 to the financial statement by saying the company had an option to redeem by paying $300,000, a sum which all knew the company did not have. The so-called prospect of redemption was then used to conjure up visions of a net worth of $897,000 after redemption. They knew and are charged with knowledge that in a whole year of operation the company, while collecting over $200,000 from the sale of stock and investment certificates, had not devoted a single dollar of the company's assets to the purposes for which the corporation was purportedly created, but instead had squandered and spent vast sums of the company's assets in salaries, loans to officers on travel expenses, for household furniture, rental of Cadillac automobiles for officers, all without having earned one dime for stockholders or investors. The very balance sheets and statements of condition contained in the second prospectus, which were prepared by Defendant Bruce from information supplied by Defendants Blackwood and Walker, showed on their face that for the year 1967 the company had incurred a net loss of $131,825 and that for the period from January 1, to February 13, 1968 it had incurred a net loss of $693,196.50. The balance sheet as of February 16, likewise appearing in the second prospectus, showed a deficit net worth at that time of $89,005.33 and an earned deficit, after quasi-reorganization, of $112,452.63. The notes to these financial statements if not flagrantly false, are patently misleading and deliberately fraudulent. Note 2, for example, shows the unaudited net worth of a subsidiary (Babee-Tenda Products Corporation) as $289,000, as against a cost to the company of $77,659 which, as the footnote claims, shows an unaudited appreciation in the book value of the company in excess of $211,000. Note 2 to the financial statement, however, discloses on its face that the so-called subsidiary had just come out of bankruptcy, and the evidence shows that

at the time it had no plant, and was not even a going concern. Numerous other frauds and attempts at deception might be cited but these should suffice.

As indicating the cynical knowledge of the parties as to the scope of the fraud being perpetrated the accountant, Defendant Bruce, facetiously enclosed to Blackwood, who was to obtain the second prospectus, an additional footnote as a jest or joke. This little joke between Bruce and Blackwood, and which Bruce facetiously suggested be added, read as follows:

> "The current deficit of the company was due largely in part to mismanagement by the President, the Board of Directors, the Executive Committee, corporate counsel, the Securities and Exchange Commission, the Georgia Securities Commission, the FBI, the Governor Lester Maddox. In addition, all of the boobs that didn't waste their money by investing into this fraudulent enterprise actually did not enhance the prospects for defalcations. Management and other idiots always expect a CPA to juggle figures to present miraculous conditions which do not exist. With this particular insolvent, almost bankrupt bunch of frauds, the CPA is presenting the truth, the whole truth, and nothing but the truth, even if he has to lie to do it."

In his testimony Mr. Bruce then added:

> "And that, Your Honor, I considered a little levity which naturally would not have been included in the financial statements because it is a complete falsehood."

In his argument before the court Mr. Blackwood stated that when he first read Mr. Bruce's effort at levity he considered it "hilariously funny". For the unfortunate lay victims who invested in this fraud, and particularly the numerous widows among them, the jest must have been a cruel one indeed.

The court therefore finds all three of the defendants Guilty under Counts Nine and Fifteen of the indictment.

The court further finds the defendant Blackwood Guilty under Count Fourteen of the indictment which relates to a transaction relating solely to him and charging a violation of 15 U.S.C. § 77e(a), Nunc pro tunc as of the 21st of November, 1972, and the court finds defendants Walker and Bruce Not Guilty under Count Fourteen.

This 8th day of February, 1973.

/s/ NEWELL EDENFIELD
United States District Judge

INDEX

CITATIONS

Cases: Page

Barnes v. *United States*, 412 U.S. 837 11

Blockburger v. *United States*, 284 U.S. 299 11

Bronston v. *United States*, 409 U.S. 352 9

Gavieres v. *United States*, 220 U.S. 338 11

Gore v. *United States*, 357 U.S. 386 11

Gusow v. *United States*, 347 F. 2d 755, certiorari denied, 382 U.S. 906 7

Lustiger v. *United States*, 386 F. 2d 132, certiorari denied, 390 U.S. 951 7

Silverman v. *United States*, 213 F. 2d 405, certiorari denied, 348 U.S. 828 7

Taylor v. *McKeithen*, 407 U.S. 191 12

United States v. *Lichota*, 351 F. 2d 81, certiorari denied, 382 U.S. 1027 7

United States v. *Maze*, No. 72-1168, decided January 8, 1974 11

Statutes:

15 U.S.C. 77e(a) 2

15 U.S.C. 77q(a) 1,2,7,9,11

18 U.S.C. 371 1

18 U.S.C. 1341 1,7,10,11

18 U.S.C. 1621 9

Miscellaneous:

Mathews, *Criminal Prosecutions Under the Federal Securities Laws and Related Statutes: The Nature and Development of SEC Criminal Cases*, 39 Geo. Wash. L. Rev. 901 (1971) 11

In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1291

ROBERT B. BRUCE, PETITIONER

v.

UNITED STATES OF AMERICA

No. 73-1558

ROBERT S. WALKER, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

After a jury-waived trial in the United States District Court for the Northern District of Georgia, petitioners were convicted of mail fraud in connection with sales of certain securities, in violation of 15 U.S.C. 77q(a) and 18 U.S.C. 1341, and of conspiracy to commit such fraud, in violation of 18 U.S.C. 371. Petitioner Walker was also convicted of fraud in the offer and sale of securities, in violation of 15 U.S.C.

77q(a). Petitioner Bruce was sentenced to concurrent terms of two years' imprisonment, six months to be served in jail with the balance suspended. Petitioner Walker was sentenced to concurrent terms of three years' imprisonment, The court of appeals affirmed (Pet. App. A1-A17)[1] and denied rehearing (Pet. App. A18).[2]

Petitioners' indictment and convictions were based upon the operations of American Capital Corporation, incorporated by petitioner Walker on December 13, 1966, which engaged in two offerings of securities, the first commencing in January 1967, and the second in April 1968. Petitioner Walker was president of the corporation; co-defendant Blackwood provided various legal services to the company; petitioner Bruce, a certified public accountant, was retained to provide the financial statements that were included in two prospectuses relating to the corporation's securities offerings.[3]

The corporation offered two types of securities: common stock and interest-bearing investment certificates. The ostensible purpose of the corporation was to provide loans to smaller, growing companies, and to improve upon the

---

[1]"Pet. App." refers to the appendix to Bruce's petition (No. 73-1291).

[2]Co-defendant Robert A. Blackwood was also convicted on similar charges. His conviction was affirmed, except that one count charging sale of unregistered securities, in violation of 15 U.S.C. 77e(a), was reversed (Pet. App. A16).

[3]The Georgia Securities Commission had in the early part of 1968 forbidden American to engage in further sales until a second prospectus was filed. American ceased doing business in May 1969.

mutual fund concept by promising a six percent return on the investment certificates. In fact, the trial court found that, although the corporation acquired some $200,000 from the sale of its securities, it did not endeavor to engage in the type of investment promised in the prospectuses and that it contemporaneously wasted large sums on the personal comforts of the officers, particularly petitioner Walker and Blackwood (Pet. App. A20-A21).[4]

Petitioner Walker, who, as president of the corporation, directed its operations, was adjudged guilty on fraud counts arising from both the first and second offerings, the trial court holding that he had acted in bad faith from the incipiency of the coporation's existence. The court entertained a reasonable doubt as to whether petitioner Bruce and co-defendant Blackwood had initially participated in the corporation's operation in bad faith, and accordingly found them not guilty of the charges arising from the first prospectus and offering. As to the second prospectus and offering, the court found them both guilty because, along with petitioner Walker, they "knew and could not have failed to know that the business they were conducting was a fraud" (Pet. App. A21-A22).

In addition to its general finding that American, under petitioner Walker's direction, had not sought to engage in the investment plan envisioned by the prospectuses, the trial court also determined that the two prospectuses contained a variety of financial compilations and statements which "if not flagrantly false, are patently mislead-

---

[4]An SEC accountant testified that, from his examination of its records, the corporation had never received any identifiable income from any source (Tr. V 58-59).

ing and deliberately fraudulent" (Pet. App. A22). These misleading representations in the two prospectuses consisted of the following:[5]

(a) When American was first incorporated, it acquired certain Florida land (Ridge Manor) by issuing 35,000 shares of common stock and incurring obligations amounting to $380,000, which land both the first and second prospectuses listed as having a value of $1,076,600. In fact, the claimed value of Ridge Manor was an estimated value of the property after subdivision and development, which had not yet begun and which American had not the funds to initiate. Similarly, the first prospectus failed to mention that the mortgage on the Ridge Manor land that American had purchased was overdue at the time of purchase. The second prospectus admitted in a footnote that the land had subsequently been foreclosed, but it stated that American had an option to redeem the property by June 10, 1968, upon payment of approximately $300,000 of the mortgages. This transaction, the statement indicated, would provide an equity of $775,000 and a net worth of $897,000; in fact, the company had no hopes of raising the $300,000 necessary for redemption.

(b) The first prospectus stated that the sales costs of the offered securities would not exceed 4 percent for the certificates and 15 percent for the stock. In fact, salesmen received 20 percent and 33 1/3 percent, respectively.

(c) The first prospectus listed under assets a note receivable for $20,000, which a later footnote states

---

[5]We are lodging with the Clerk the court of appeals appendix, which contains copies of both the first and second prospectuses (pp. 85, *et. seq.*).

was due from an officer (Blackwood) on December 8, 1967, and bore interest of 6 percent per annum. The footnote further stated that the only security for the note was 40,000 shares of American. In fact, the note contained on the back a stipulation that it could only be satisfied from the 40,000 shares and did not represent a general indebtedness on the part of Blackwood.

(d) In the second prospectus, under assets, cash at hand was listed as $42,809.35. Hidden in a general footnote several pages later, however, was the statement that a $40,000 bank loan was secured by collateral of unspecified value, consisting of a restricted savings account at the lender bank, and that that savings account had been used to pay off the loan after the date of the accountant's financial statement appearing in the prospectus. Another $2,000 had recently been committed, by a check still outstanding, as a down payment for an airplane. Thus, the actual cash assets should have been listed as $809.35. In addition, the liability incurred for the airplane purchase was not listed under liabilities.

(e) Also listed under assets in the second prospectus was an entry for "Investment in wholly-owned subsidiary, at cost," which was given a value of $77,659.28. A later footnote explained that American had acquired the assets of Babee-Tenda Safety Products, a company that had been adjudicated bankrupt, in return for 26,388 shares of American ($0.10 par value) and the assumption of $75,020 of notes payable by Babee-Tenda. The footnote further explained that American planned to build a new plant for the newly acquired subsidiary, that the "unaudited" sales of Babee-Tenda had been $2,000,000 per year, and that the "unaudited" net worth of Babee-Tenda was some $289,000, thus resulting in an appreciation in book value to American of $211,000. The district court found, however, that this $77,000 "asset" was in fact of questionable actual worth

• because American at the time had no reasonable hope of securing enough capital to revitalize the subsidiary (Pet. App. A22-A23).

(f) The second prospectus indicated that the total amount paid in salaries to company officers did not exceed $16,000. But, while listing a variety of expenses under "Comparative Statement of Income and Expenses,"[6] the prospectus failed to disclose that, of those expenses, petitioner Walker had received some $47,000 worth of benefits in the form of payments of personal automobile loans, other personal loans, apartment rental, etc. In total, petitioners and Blackwood received approximately $60,000, or 20 percent of the capital received by the corporation.

(g) Although the company was in dire financial condition by the time of the second prospectus, that document sought to induce false confidence in the company by placing a notice on the first page stating that the interest yield on investment certificates had been raised from six to seven percent.

That petitioners did not participate in American's operation and sales in good faith was highlighted in a facetiously suggested footnote that petitioner Bruce, the C.P.A., forwarded to Blackwood (Pet. App. A23):

> The current deficit of the company was due largely in part to mismanagement by the President, the Board of Directors, the Executive Committee, corporate counsel, the Securities and Exchange Commission, the Georgia Securities Commission, the F.B.I., the Governor Lester Maddox. In addition, all of the boobs that didn't waste their money by investing into this fraudulent enterprise actually did not enhance the prospects for defalcations. Management and other

[6]This included approximately $131,000 for 1967.

> idiots always expect a C.P.A. to juggle figures to present miraculous conditions which do not exist. With this particular insolvent, almost bankrupt bunch of frauds, the C.P.A. is presenting the truth, the whole truth, and nothing but the truth, even if he has to lie to do it.

1. Both petitioners argue that the court of appeals applied an incorrect legal standard in determining whether the evidence supported the district court's findings of fraud. Petitioners also contend that the courts of appeals improperly held that one who offers the securities of a financially-troubled business will be deemed criminally liable for fraud should the enterprise fail.

Contrary to petitioners' suggestion, the court of appeals did not establish an overly broad or novel definition of fraud, predicated only upon a standard of "moral uprightness." Rather, after referring to the language quoted by petitioners, the court adhered to the traditional principle that, in a fraud prosecution under Sections 1341 or 77q(a), the government must demonstrate "a scheme reasonably calculated to deceive persons of ordinary prudence and comprehension" (Pet. App. A12). This is a test of long-standing application. See *Silverman* v. *United States*, 213 F. 2d 405, 407 (C.A. 5), certiorari denied, 348 U.S. 828; *Gusow* v. *United States*, 347 F. 2d 755, 756 (C.A. 10), certiorari denied, 382 U.S. 906; *United States* v. *Lichota*, 351 F. 2d 81, 89 (C.A. 6), certiorari denied, 382 U.S. 1027; *Lustiger* v. *United States*, 386 F. 2d 132, 138 (C.A. 9), certiorari denied, 390 U.S. 951.[7]

---

[7]In full, the court discussed the issue of fraud as follows (Pet. App. A12):

> Essentially, a scheme to defraud is measured by a nontechnical standard. "It is a reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the

In petitioners' case, although the prospectuses did indicate that the corporation had a deficit net worth, the various financial statements in the prospectuses were unquestionably designed to deceive the ordinarily prudent individual into believing that the corporation possessed a potential for profit, when in fact petitioners and Blackwood recognized that the business would not succeed. As the district court found, the representations were, "if not flagrantly false,* * * [then] patently misleading and deliberately fraudulent" (Pet. App. A22).

For example, while the second prospectus mentioned that Babee-Tenda was acquired out of bankruptcy, it was listed as having a net worth of $289,000 and sales of $2,000,000 per year, when in fact the corporation was no longer an on-going operation, and American had no reasonable financial prospects for its revitalization. Nor did the prospectus mention, in a listing of corporate expenses, that twenty percent of the capital previously acquired had been channeled into personal benefits for the company officers. The value of the Ridge Manor property was inflated to reflect its value when subdivided; similarly, while foreclosure on the Ridge Manor property was revealed, the prospectus, by suggesting an option to redeem when no funds to do so were available, incorrectly represented that the corporation would be solvent once the too highly-valued

---

general and business life of members of society", *Gregory* v. *United States*, 5 Cir., 1958, 253 F. 2d 104, 109.

The scheme need not be fraudulent upon its face or misrepresent any material fact. All that is necessary is that it be a scheme reasonably calculated to *deceive* persons of ordinary prudence and comprehension. The intent of the crime is shown by the scheme itself—here, the active promotion of a company known to be inescapably insolvent by making impossible representations of possible wealth to potential investors * * *.

property was reacquired. Finally, to list cash assets at in excess of some $43,000 and to obliquely indicate in a footnote that $40,000 of that amount represented proceeds of a loan which had already been repaid, can only be deemed an attempt to mislead.

Petitioners thus err in characterizing the holding below as imposing potential criminal liability on anyone who offers securities in a financially-troubled enterprise. The court of appeals found criminal responsibility based on a finding that petitioners and Blackwood " 'knew and could not have failed to know that the business they were conducting was a fraud' " (Pet. App. A11) in which none of the company's funds obtained through securities sales had been invested for the purposes stated.[8]

2. Petitioner Walker also argues that he was improperly subjected to double punishment by his conviction on counts Two and Twelve of the indictment, which involved the transaction in which both a letter and a stock certificate for three hundred shares of American were mailed to a purchaser on November 3, 1967. Count Two charged a violation of 15 U.S.C. 77q(a), while Count Twelve

---

[8]Petitioner Walker's reliance (Pet. 9-10) upon *Bronston* v. *United States*, 409 U.S. 352, is misplaced. That case involved the question whether a literally true but unresponsive and misleading answer to a question posed during cross-examination of a witness constituted perjury, in violation of 18 U.S.C. 1621. As this Court noted, the witness's answer in *Bronston* was "not to be measured by the same standards applicable to criminally fraudulent * * * statements. In that context the law goes 'rather far in punishing intentional creation of false impressions by a selection of literally true representations, because the actor himself generally selects and arranges the representations.' " 409 U.S. at 358, n. 4.

alleged a violation of 18 U.S.C. 1341.[9] We note ini-

[9]The exact wording of the two counts, not accurately reproduced in Walker's petition (pp. 12-13), are as follows:

> *Count Two:* 1. The grand Jury realleges all of the allegations contained in paragraphs 1 to 18, inclusive, of Count One of this indictment.
>
> 2. On or about November 3, 1967, the defendants and West did willfully and unlawfully, in the offer and sale of a security, namely, the common stock of American Capital Corporation, by use of the mails, employ the aforesaid scheme and artifice to defraud, obtain money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and engage in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of said securities, including Thomas D. Wyatt, said use of the mails being as follows: On or about November 3, 1967, in the Northern District of Georgia, the defendants and West willfully caused a letter dated November 3, 1967, enclosing a stock certificate of American Capital Corporation, to be delivered by the Post Office Department to Thomas D. Wyatt, 512 Fairground Street, Apt. B, Marietta, Georgia 30060; in violation of Section 77q(a), Title 15, U.S. Code.
>
> *Count Twelve:* 1. The Grand Jury realleges all of the allegations contained in paragraphs 1 to 18, inclusive, of Count One of this indictment as constituting and describing a scheme and artifice which the defendants and West devised and intended to devise to defraud and to obtain money and property by means of false and fraudulent pretenses, representations and promises.
>
> 2. On or about November 3, 1967, in the Northern District of Georgia, the defendants for the purpose of executing the aforesaid scheme and artifice to defraud and attempting to do so, unlawfully, willfully and knowingly caused to be delivered by U.S. Mail according to the direction thereon an envelope and contents addressed to Mr. Thomas D. Wyatt, 512 Fairground Street, Apartment B, Marietta, Georgia, 30060, said contents consisting of a letter on American Capital Corporation *stationery dated November 3, 1967 and signed Robert F. Walker, President, and a stock certificate for 300 shares of stock in American Capital Corporation;* in violation of Section 1341, Title 18 U.S. Code. [Emphasis supplied.]

The emphasized portion was omitted through an apparent printing error.

tially that there is no need for the Court to address this issue, as petitioner received concurrent sentences on Counts Two and Twelve, as well as on the other ten counts for which he was convicted. See *Barnes* v. *United States*, 412 U.S. 837, 848, n. 16.

In any event, petitioner Walker's contention (Pet. 14-15) that the court of appeals "has announced a new double jeopardy test" at variance with *Gavieres* v. *United States*, 220 U.S. 338, upon which petitioner relies, is unfounded. The court of appeals (Pet. App. A13) explicitly relied upon the standard set forth in *Gavieres*—that each statute allegedly violated requires proof of a fact that the others do not. See also *Blockburger* v. *United States*, 284 U.S. 299, 304. The question whether the court of appeals properly applied that test to the particular facts of this case is not one of general importance warranting review by this Court.[10]

3. Petitioner Bruce argues that the failure of the court of appeals specifically to address in its opinion certain issues raised on appeal denied him due process. The third

---

[10]Section 77q(a) requires proof of an "offer or sale of * * * securities," which Section 1341 does not, while the latter requires that the use of the mails be "for the purpose of executing" a scheme to defraud (cf. *United States* v. *Maze*, No. 72-1168, decided January 8, 1974, slip op. 10), which the former does not. See generally Mathews, *Criminal Prosecutions Under the Federal Securities Laws and Related Statutes; The Nature and Development of SEC Criminal Cases*, 39 Geo. Wash. L. Rev. 901, 921-923 (1971). These distinctions reflect the fact that Sections 77q(a) and 1341 constitute different "regulatory controls devised by Congress as means for dealing with a social evil * * *" (*Gore* v. *United States*, 357 U.S. 386, 389), fraudulent securities transactions in Section 77q(a), and misuse of the mails in Section 1341.

of these proffered issues—whether the district court erred in denying a motion for judgment of acquittal—simply disputes whether the evidence was sufficient to support petitioner Bruce's conviction. This evidence, fully discussed in the opinion of the court of appeals and summarized above, sufficiently supports the district court's guilty verdict. In any event, as to that and the other two issues mentioned,[11] there is no reason to assume that the court of appeals did not consider them, and the failure to address them expressly in its opinion did not deny petitioner due process. See *Taylor* v. *McKeithen*, 407 U.S. 191, 194, n. 4.

It is therefore respectfully submitted that the petitions for writs of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

AUGUST 1974.

---

[11]First, petitioner Bruce contends that a government witness who testified as to generally accepted accounting procedures was not qualified. To the contrary, the witness, George Callahan, had engaged in private practice for two years, had worked with the Internal Revenue Service for nine years, was currently Chief Regional Accountant for the Securities and Exchange Commission, was a certified public accountant, and currently spent approximately 60 percent of his working time on accounting matters (Tr. V 33-34). Secondly, it is contended it was improper for the prosecutor to elicit from petitioner Bruce during cross-examination that he had been decertified in an unrelated case. However, on direct examination petitioner Bruce had testified as to his professional licensing, and represented himself as being a C.P.A. cognizant of currently accepted accounting techniques The questioning of him as to this matter was thus within the proper scope of the government's cross-examination (Tr. VI 143-149).